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Introduction

In accordance with the City Auditor's 1999-00 Audit Workplan, we have audited the Building Division (Division) building permit fee process. The Division is part of the Department of Planning, Building, and Code Enforcement (Department). This audit is the first in a series of audit reports on the Division. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

The City Auditor's Office thanks the Department, Division, and Budget Office staff who gave their time, information, insight, and cooperation during the audit process.

Background

The Division's mission is to protect the lives and safety of the citizens of San Jose and contribute to the City's economic development. This is accomplished through implementation and enforcement of the Building, Plumbing, Mechanical, and Electrical Codes. The Division also implements Engineering, Energy and Disabled Access regulations, and local and State laws for new construction.

The Division's role in the development process begins by reviewing all construction plans for new residential, commercial, and industrial buildings and alterations to those buildings. Plan Check Engineers review the plans to verify that the proposed construction project is designed to meet minimum safety requirements specified in the codes. When the Division determines that the building plans comply with applicable codes, the Division issues building permits authorizing construction. During a structure's construction phase, Division inspectors will perform on-site inspections to verify compliance with the approved building plans, and applicable local and state regulations. After a final inspection, the Division is supposed to issue certificates of occupancy for each new building. This certifies that the building meets all the appropriate codes, structural, zoning, health, safety, and access regulations and is safe to inhabit or occupy.

Budget And Staffing

In 1999-00, the Division's budget was $14.6 million, which included $11.6 million in personal services and $3.0 million in non-personal services (including equipment). Building-related permit fees fund almost all of the Division's operating costs.

The Chief Building Official heads the Division, which is organized into three main sections: Permit Center, Plan Check Section, and Inspection Section. In 1999-00, the Division was authorized 136.9 full-time equivalent positions, of which 133.7 were fee-supported positions.

Building Permit And Plan Check Revenue Collected

In 1998-99, the Division collected $17 million in revenue from Plan Check, Permit (Building, Plumbing, Electrical, and Mechanical), Record Retention, and miscellaneous fees assessed for residential, commercial, and industrial projects. This was a 13.2 percent or $2.6 million decline from the previous fiscal year. About 31.3 percent of the total revenue is attributable to fees collected from new residential construction.

Total Building Revenue Increased Significantly

In the mid-1990's, total Division plan check and building permit revenue increased significantly. Exhibit 1 summarizes total building-related permit revenues from 1989-90 through 1998-99.

Exhibit 1 Summary Of Building Permit Revenues 1989-90 Through 1998-99

Fiscal Year	Building Permit Revenue	Increase (Decrease)	Percent Increase (Decrease)
1989-90	$5,600,640	--	--
1990-91	$6,119,422	$518,782	9.3%
1991-92	$6,298,068	$178,646	2.9%
1992-93	$6,012,056	($286,012)	(4.5%)
1993-94	$7,691,967	$1,679,911	27.9%
1994-95	$7,520,668	($171,299)	(2.2%)
1995-96	$11,861,230	$4,340,562	57.7%
1996-97	$15,537,533	$3,676,303	31.0%
1997-98	$19,532,517	$3,994,984	25.7%
1998-99[1]	$16,962,931	($2,569,586)	(13.2%)

[1] A contributing factor to the decline was a reduction in certain building-related permit fees.

Source: Auditor analysis of Building Division data.

Building Division Utilizes Valuation Method For Calculating Permit Fees

The Division reviews building plans and issues building permits for a myriad of construction-related activities. These activities include items such as installing a water heater, building a new home or office building, or installing a new roof. The Division assesses fees for reviewing building plans, issuing building permits, and inspecting building projects.

The Division uses a City Council-approved fee schedule to assess permit fees. Since building fees cannot exceed cost-recovery, the Division adjusts fees to match expected revenues.

The Division follows the International Conference of Building Officials' (ICBO) method for charging building permit fees. Under the ICBO method, building permit fees are calculated based on a structure's valuation and use, construction type, and square footage.

This method is documented in a permit fee table contained in the Uniform Building Code (UBC).[1] The Division's current permit fee table is contained in the Building and Structure Permits Fee Schedule, effective July 1, 1999 to June 30, 2000. This permit fee table is similar to the UBC permit fee table contained in the 1988 UBC. The Division last adjusted its permit fee table in 1990. Exhibit 2 shows the City's current building permit fee table that applies to residential and non-residential construction.

Exhibit 2 Building Permit Fee Table 1999-00

Total Valuation	Fee
Less than $1,221	$43
$1,221 to $2,000	$43 for the first $1,220 plus $2.50 for each $100 increment
$2,001 to $25,000	$62.50 for the first $2,000 plus $10 for each $1,000 increment
$25,001 to $50,000	$292.50 for the first $25,000 plus $7 for each $1,000 increment
$50,001 to $100,000	$467.50 for the first $50,000 plus $5 for each $1,000 increment
More than $100,000	$717.50 for the first $100,000 plus $2.50 for each $1,000 increment

Source: Building Division.

Using the above table, a construction project valued at $100,000 would pay $717.50 in building permit fees, while a construction project valued at $200,000 would pay $967.50 ($717.50 + $250).

Valuation Is A Measure Of Local Construction Costs

The UBC provides that the local building official is responsible for determining a project's valuation. The Division uses the project's valuation to calculate building permit fees and development taxes, and to indirectly calculate plan review fees. The Municipal Code (24:01.290) has established that building valuation shall be the estimated cost to replace the building and its service equipment based on current replacement costs. In

[1] The ICBO updates and publishes the UBC every three years. Many states, cities, and counties in the United States have adopted the UBC. The UBC contains the minimum requirements for safe construction and occupancy of buildings.

addition, the Code specifies that in no case shall the valuation be less than the published valuation tables in the latest edition of the ICBO Building Standards magazine. These tables contain valuation data that represents the construction cost for most types of buildings.

Separate Valuation Rate Used For Residential Projects

In 1989, the City Council enacted an ordinance that established a separate valuation rate for residential construction (single family, multi-family, and alterations[2]). The ordinance mandated the specific use of the average rate shown in the ICBO valuation table, Dwellings Type V—Wood Frame Dwelling. As of April 2000, this valuation rate equaled $62.50 per square foot. The ordinance also prohibited the use of the regional modifier for determining residential valuation.[3]

Audit Scope, Objectives, And Methodology

Our audit scope was to review the Division's building permit fee process as of 1999-00, and to determine if the Building Program was cost-recovery and in compliance with applicable legal requirements. We interviewed Division and Budget Office staff responsible for establishing and tracking building fee revenues and Building Program costs. We obtained and reviewed budget information for building fee revenues and Building Program costs from the Division and Budget Office. We did not test the accuracy and reliability of this data. We also obtained and reviewed extensive documentation and manuals on establishing building permits and establishing the cost of municipal services.

Major Accomplishments Related To This Program

In Appendix B, the Building Division informs us of its major accomplishments.

[2] In 1999, an amended ordinance replaced the term "alterations" with "addition projects."

[3] The Division uses a regional modifier for calculating non-residential valuation.

Finding I A Cost Of Service Effort Should Result In Building Permit Fees That Are Able To Withstand Political And Public Scrutiny

According to State of California (State) law, building permit fees cannot exceed the reasonable estimated cost of providing service. In addition, the California Attorney General and Legislative Counsel have issued opinions regarding establishing building permit fees. Further, a City of San Jose (City) policy requires that building fees be 100 percent cost-recovery. Based on our review of the building permit fee process, we found that the Building Division (Division) lacks appropriate and complete cost of service information. Specifically, we found the following limitations with the Division's current permit fee process:

- The Division cannot demonstrate that its fees are based on the actual cost of providing specific building-related services and
- The Division is not properly accounting for works-in-progress or long-term capital/asset acquisitions.

As a result, the current methodology makes it difficult for the Division to substantiate that its building permit fees satisfy State and City requirements.

In our opinion, the Division should 1) conduct regular cost of service studies; 2) implement a fee structure based on a cost-revenue allocation method; 3) account for end-of-fiscal-year works-in-progress; and 4) account for certain costs on a long-term basis. By so doing, the City's building permit fees will be able to withstand public and political scrutiny and the building program will be more equitable and accountable to its customers.

Building Permit Fees May Not Exceed The Reasonable Cost Of Providing Service

State law prohibits local agencies from charging more than the reasonable cost of providing a service. Both the California State Constitution and the Government Code regulate building plan check and inspection fees. In general, building fees may not exceed the estimated reasonable costs of the services rendered. Specifically, California Government Code Section 66014 (a) establishes that when local agencies charge fees for building inspections and building permits, those fees should not exceed the reasonable cost of providing the services. Moreover, if the fees result in revenues in excess of actual cost, those revenues shall be used to reduce the fee that created the excess.

Attorney General And Legislative Counsel Have Issued Opinions On Building Permit Fees

In addition to the California Government Code, the Attorney General and Legislative Counsel have issued opinions on establishing building permit fees based on fee schedules. Both have opined that building departments should not rely on published valuation tables and fee schedules without supporting evidence to show that permit fees do not exceed the estimated cost of providing service. In 1993, the Attorney General provided an opinion on the issue of charging building permit fees based on the Uniform Building Code (UBC) fee schedule. The Attorney General opined the following:

1. A local agency is prohibited from charging building permit and similar fees which exceed the estimated reasonable costs of providing the services rendered unless the amounts of the fees are approved by the electorate;

2. A local agency may not charge building permit and similar fees based upon the UBC valuation tables which are in excess of the estimated reasonable costs of providing the services rendered unless the amounts of the fees are approved by the electorate;

3. If a local agency charges building permit and similar fees based upon the UBC valuation tables <u>without</u> supporting evidence regarding the relationship between the fees and the services rendered, such fees are invalid to the extent they exceed the reasonable costs of providing the services rendered.

In 1997, the Legislative Counsel of California issued an opinion letter, <u>Building Inspection and Permit Fees</u>, which addressed the issue of whether building departments may use the fee schedules from the California Building Code, which adopts the UBC by reference. The Legislative Counsel opined that “the city building department may not use the fee schedules found in the valuation tables set forth in the California Building Code to establish fees…but is required to limit these fees to the estimated costs of providing the services rendered.”

Additionally, in 1994, a Grand Jury in Riverside County, California held a hearing on building permit and development fees. During the hearing, the Grand Jury heard testimony from representatives from the International Conference of Building Officials (ICBO) that there is no empirical data that the fees contained in the UBC permit fee table related to the cost of services local jurisdictions rendered. The Grand Jury reported that it was common practice for jurisdictions to accept the fee tables in the UBC without independent investigation to determine that each fee has a reasonable relationship to the costs incurred in providing the service.

City Policy Requires Building Permit Fees To Be Cost-Recovery

The City of San Jose (City) has a policy that building-related permit fees, which are classified as Category I fees, should be cost-recovery. That is, the City is supposed to establish building permit fees to recover the full cost of providing building-related services. We found that the Administration's primary concern regarding this issue is that the entire Building Program should be cost-recovery. The Administration considers the Building Program to be cost-recovery if total revenues are equal to total costs. The Administration does not ensure that each specific fee category, such as residential plan check, or building inspection is cost-recovery.

Current Building Permit Fee Process Is Insufficient To Ensure 100 Percent Cost Recovery

Based on our review of the Division's building permit fee process, we found that the Division lacks appropriate and complete cost of service information. Specifically, we found the following limitations with the Division's permit fee process:

- The Division cannot demonstrate that its fees are based on the actual cost of providing specific building-related services and
- The Division is not properly accounting for works-in-progress or long-term capital/asset acquisitions.

The Division Cannot Demonstrate That Its Fees Are Based On The Actual Cost Of Providing Specific Building-Related Services

We found that the Division cannot demonstrate that its fees are based on the actual cost of providing specific building-related services. Consequently, the Division's reliance on a fee schedule without supporting evidence is inconsistent with the Attorney General's and Legislative Counsel's opinions regarding building permit fees.

The Division utilizes a City Council-approved fee schedule to assess permit fees for construction-related activities, such as installing a water heater, building a new home or office building, or installing a new roof. The Division also issues permits and assesses fees for reviewing building plans and inspecting building projects. We determined that the fee table utilized for calculating building permit fees is similar to the UBC fee schedule contained in the 1988 UBC. The Division last adjusted its permit fee table in 1990. Division officials were unable to provide us with specific cost information to show the UBC fee schedule results in revenue that matches the cost of providing each specific service.

The Division needs to link the permit fees charged and the cost of services provided to customers. For example, a 4,000 square foot single family home with a 500 square foot garage, would be valued at $261,250. As shown Exhibit 3, the Division would charge the homeowner $3,146 in building-related fees--a $943 plan check fee and $2,203 in building, electrical, plumbing, and mechanical permit fees.

Exhibit 3 Valuation And Permit Cost For A Single Family Residence

Single Family Residence	Amount
Valuation Rate Per Square Foot[1]	$62.50
Square Footage-Home	4,000
Square Footage-Garage	500
Total Valuation	**$261,250**
Plan Check Fee	$943
Building Permit	$1,123
Electrical, Plumbing and Mechanical Permit	$1,080
Total[2]	**$3,146**

[1] There is a separate valuation rate for a detached garage of $22.50 per square foot.

[2] This total does not include permit issuance and record retention fees.

Source: Auditor analysis of fee schedule.

However, the Division cannot document that the $3,146 in fees it charges is comparable to what it costs to provide plan check and inspection services. Specifically, the Division does not have information on how the number and type of inspections required for a single family home translates into the cost and resources needed to perform those inspections. By establishing this type of information, the Division can reconcile the permit fees charged against the cost of the services provided to their customers.

We also determined that the Government Finance Officers Association (GFOA) and the International City Management Association (ICMA) have issued guidance on making user fees, such as building fees, cost-recovery. The GFOA recommends calculating the full cost of providing a service in order to establish a basis for setting a fee. Moreover, the GFOA recommends reviewing and updating fees based on the impact of increased costs, the adequacy of coverage of costs, and current competitive rates. Similarly, the ICMA recommends specific steps for calculating user fees, including estimating the cost of direct labor, calculating capital costs, determining and comparing direct and indirect costs, and calculating the total unit cost.

Without complete cost information, administrators cannot determine the total cost of providing a service, thus, they cannot accurately price the service. The City Council and Administrators need complete cost information, because according to ICMA guidance on financial management, "knowing the cost of providing a service provides one basis to establish a fee or charge." According to the ICMA, maintaining complete and accurate cost information would inform local officials if "the true cost of providing a service is far beyond . . . what state law would permit." Further, the same ICMA guidance reports that "accurate cost information provides the foundation to determine public policy issues such as rate setting, general tax levy support for the activity, user's ability to pay, cost by type of user, and cost and method of collection."

We also found that the Department's failure to use cost of service data is at variance with ICBO-recommended practices concerning the need to maintain appropriate cost data. The ICBO asserts "it is generally assumed that local jurisdictions utilizing the UBC permit fee table will periodically document service costs and compare the cost of plan check and inspection services to the fees charged for those services." The Division does not follow this recommended practice.

The Division Can Utilize Alternative Approaches To Better Withstand Public And Political Scrutiny

The Division's current approach for ensuring that the building program is cost recovery differs from ICBO recommended practices and current trends in other jurisdictions. We found that the ICBO and some other jurisdictions—

- Use alternative fee schedules based on cost per occupancy type and average square footage, as opposed to valuation based fee schedules and
- Conduct regular cost of service studies to determine cost recovery.

ICBO Recommends Non-valuation Based Fee Schedules

In 1998, the ICBO published a manual, Establishing Building Permit Fees, which was "intended to assist local building officials in documenting plan check and inspection service costs, and developing fee schedules that will withstand public scrutiny." Specifically, the manual presents different methodologies for recovering the cost of local jurisdiction plan check and inspection services. The methodologies offer different approaches for establishing plan check and inspection fees that are based upon the costs of services rendered, rather than on the value of the construction project.

As noted above, the Division bases its building permit fees on the UBC fee schedule and determines cost recovery by comparing total costs to total revenues. The ICBO calls this method Total Cost/Total Revenue. In other words, identify all the Building Program's costs of services and compare those costs to the total fees collected from service users. This method requires taking all sources of revenue into consideration, including building, plumbing, electrical, and mechanical permit fee revenues. A problem with this method is that cost-recovery targets may not be met.

According to a consultant who did a cost of service study for the City of Portland, Oregon, the UBC fee schedule method "give the appearance of fairness, and are relatively easy to administer." However, the consultant reported that under- or over-recovery could occur because there is "a lack of linkage between project valuation and the actual level of effort required to process a permit."

We also determined that the ICBO reported that many jurisdictions used the UBC building permit fee schedule to determine permit fees. However, the ICBO also reported that the Total Cost/Total Revenue method was favored by smaller jurisdictions because it lacked complexity and was less costly than more complex cost-recovery systems.

Alternatively, the ICBO proposed a Cost/Revenue Allocation methodology[4] for establishing plan check and inspection fees based on the cost of services provided, as opposed to setting fees based on the value of the construction permitted. The objective of this methodology is to establish a link between the cost and fees for plan check and inspection services rendered by project type. Typical projects can include new commercial, commercial alterations, new residential (single family and multi-family), and residential alterations.

The first step of this method requires documenting the cost of providing building permit services for a prior period, including the revenues collected for those services. The period of time can range from one to three years. The total square footage for each project type for which the Division issued a permit is identified. The percentage of total square footage of construction in each category is then calculated. Next, the Division estimates the percentage of plan check and inspection time spent on different project types. These time estimates may be based upon staff estimates or derived from inspection and permit records. Then the Division multiplies the percent of time spent by project type by plan check fee revenues and building permit fee revenues in order to allocate revenues by project type. The Division finally divides the allocated revenues by the total square footage for each project type in order to determine the per square foot revenues received for services rendered. These per square foot figures are then used to calculate the plan check and building permit fees charged per square foot for the next period.

Exhibit 4 illustrates this methodology assuming the Division received $240,000 in plan check fees and $360,000 in building permit fees for five project types totaling 850,000 square feet.

[4] The ICBO makes a distinction between a cost/revenue allocation method and a modified cost/revenue allocation method. The main difference is that the modified cost/revenue allocation method relies on data from a statewide survey of California jurisdictions to calculate plan check and inspection fees for new residential construction. For this audit we did not make any distinction between these methods. Instead, we focused on the general approach for recovering costs and establishing fees.

Exhibit 4 Allocation Of Plan Check And Inspection Fees Based Upon Type And Volume Of Construction – Assuming The Division Received $240,000 In Plan Check Fees And $360,000 In Building Permit Fees

Project Type	Square Footage	Percent Of Plan Check And Inspection Time	Allocation Of $240,000 Of Plan Check Fees/Fees Per Square Foot	Allocation Of $360,000 Of Building Permit Fees/ Fees Per Square Foot
New Commercial	200,000	15%	$36,000/$0.18	$54,000/$0.27
Commercial Alteration	100,000	10%	$24,000/$0.24	$36,000/$0.36
New Multi-Family	150,000	15%	$36,000/$0.24	$54,000/$0.36
New Single Family	350,000	45%	$108,000/$0.31	$162,000/$0.46
Residential Alteration	50,000	15%	$36,000/$0.72	$54,000/$1.08
Total	**850,000**	**100%**	**$240,000**	**$360,000**

Source: ICBO.

Using the above table, new single-family residential plan check fees would equal $0.31 per square foot and building permit fees would equal $0.46 per square foot. However, plan check fees for residential alterations would equal $0.72 per square foot and building permit fees would equal $1.08 per square foot. Further, under this method, the per square foot fee amounts can be adjusted to achieve cost-recovery based on prior year results.

Some California Jurisdictions Are Moving Away From The UBC Fee Schedule

We also found that some California jurisdictions have adopted or are considering using methodologies other than the UBC fee schedules to establish building fees. For example, the Chief Building Official in Anaheim, California, told us they retained a consultant to develop a Cost/Revenue Allocation methodology for their jurisdiction. In addition, in July 1999, the County of San Diego, California stopped its practice of using the UBC fee schedules for assessing plan check and building fees for residential construction. Instead the County of San Diego Board of Supervisors approved a method for assessing building fees based on overhead costs, salary and hourly rates for staffing time, and computerized tracking of time incurred on each project.

Regular Cost Of Service Studies Are Beneficial

A key component in ensuring that a program is cost-recovery is to conduct cost of service studies on a regular basis. Cost of service studies entail identifying services provided, calculating the full costs (direct and indirect) of providing those services, and evaluating the revenues received for those services. Additionally, a cost of service study specific to a building department should include determining the effective level of service to be provided. Typical level of service measures would include indicators, such as

- Plan check turnaround time;
- Lead time for inspection requests;
- Time spent by customers waiting for service at the Permit Center;
- Average number of daily inspections per inspector, and
- Number of plan check rechecks required.

We found that the Building Program last underwent a cost of service study over six years ago. At that time the Division calculated the full cost of providing City services and compared those costs with the revenues those services generated.

During our audit, concern about declining building fee revenues prompted the Administration to retain DMG Maximus to conduct a cost of service study on the building and planning fees. The study scope includes reviewing expected fee recovery levels for 2000-01, and recommending fee modifications.

In our opinion, this cost of service study is an excellent idea. Performing regular cost of service studies, especially during a fluctuating building economy, provides administrators with current cost information and helps to identify potential under- or over-recovery of costs. Additionally, we found that other municipalities perform cost of service studies on a more regular basis than does the City. For example, the City of Phoenix, Arizona, requires annual user fee reviews on the extent to which designated programs, such as building inspection, are projected to recover applicable costs from user fees. Another example is the City of Portland, Oregon, which has cost of service guidelines that recommend updating cost of service studies every two years.

Any cost of service study that is performed should include an analysis to develop a fully-loaded hourly rate for plan check and inspection services. The Division has used $85 per hour as its standard hourly rate since July 1, 1993. In our opinion, this rate by definition is out of date, should be reviewed and, if necessary, changed.

We recommend that the Building Division:

Recommendation #1

Regularly conduct or cause to be conducted a comprehensive cost of service study that

- **Calculates the full cost (both direct and indirect) of providing building-related services by project type;**
- **Compares the identified program costs with building fee revenues currently received for those services; and**
- **Identifies achievable building fee recovery levels based on the cost of those services.**

Recommendation #2

Implement a fee schedule that results in the assessment of fees that are commensurate with the cost of providing service.

The Division Is Not Properly Accounting For Works-In-Progress Or Long-term Capital/Asset Acquisition

The Division does not properly account for works-in-progress. In addition, the Administration's method for paying for long-term assets skews the Division's cost-recovery picture. As a result, it is not possible to verify if the fee programs generate sufficient revenues or if identified costs truly represent the cost of providing service.

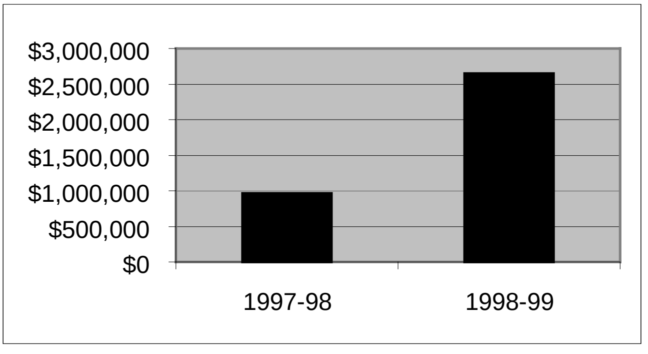
We found that the Administration's primary cost-recovery concern is that the entire Building Program be cost-recovery as opposed to ensuring that each specific fee category, such as residential plan check, or building inspection, be cost-recovery. The Budget Office utilizes a total cost and total revenue approach to determine cost recovery. This approach requires that total Building Program costs, including personnel, budget additions, and overhead, are compared against total revenue received from building–related permit fees. Using this method to evaluate cost-recovery, the Budget Office concluded that the Building Program is cost-recovery because revenues have matched costs for the last two fiscal years.

For example, in 1998-99, Building Program revenue totaled $17.7 million and costs also totaled $17.7 million. However, the $17.7 million in costs included $1.8 million in re-budgeted items and $1.7 million set aside in a Building Reserve Fund for the next fiscal year. Similarly, in 1997-98, the Budget Office calculated Building Program revenue and costs at $19.5 million. However, the $19.5 million in costs included $0.7 million in re-budgeted items and $1 million set aside in a Building Reserve Fund for the next fiscal year.

The Building Reserve Fund Does Not Sufficiently Account For Works-In-Progress

The Administration recognizes building permit revenue in the fiscal year received. However, the Division may not provide inspection services related to those revenues until the next fiscal year or beyond. In 1998, the Administration established a policy of setting aside surplus building fee revenue in a Building Reserve Fund. Surplus revenue was identified after year-end accounting of actual building-related expenditures and revenues. The Administration created a Building Reserve Fund as a contingency against future costs exceeding revenues, and also because Building Program revenues were exceeding costs. The Administration expected that building activity would decline from its current peak and that the amount of building permit revenues would not be sufficient to cover Building Program costs. As shown in Exhibit 5, the Building Reserve Fund was $1.0 million and $2.6 million for the fiscal years ending June 30, 1998 and 1999, respectively.

Exhibit 5 Total Building Reserve Fund For The Fiscal Years Ending June 30, 1998 And June 30, 1999



Source: Budget Office

In our opinion, the Building Reserve Fund is not a true reserve because it does not take into account works-in-progress or fees related to work which still needs to be performed. Specifically, the Division receives building permit fee revenues in one fiscal year, but may not provide inspection services until the next fiscal year or beyond. As a result, the Administration applies the revenues against costs in the fiscal year received, not in the year the services are actually provided.

For example, in 1998-99, the Division received about $12.8 million in building-related permit revenue or about $1.1 million per month. If the Division received $1.1 million in permit revenue in June, the last month of the fiscal year, it is unlikely that the Division would provide inspection services for all of the permit fees received during that month because there is a lag time between issuing permits and providing inspection services.

We surveyed the ten largest cities in California, and found that six of the cities accounted for works-in-progress. We found that each of the cities that accounted for works-in-progress did so in a different manner. Specifically, Fresno carries over any remaining surplus to the next year. Riverside reviews revenues and expenses over a three-year period. Further, Sacramento accounts for works-in-progress for those projects with valuations greater than $3 million. In San Diego, the City Auditor's Office calculates the amount of works-in-progress. Finally, San Francisco accounts for works-in-progress for those projects with valuations greater than $300,000.

We also determined that Portland, Oregon used a consultant to estimate works-in-progress for permits. The consultant reviewed a list of open applications at year-end and gathered information on the 1) type of review (i.e., permit), 2) fees collected, and 3) date the application was opened. Next, the consultant determined the duration of the permitting process for individual applications processed over a two-year period. Finally, the consultant calculated both the average processing time and the unearned portion of the revenue collected based on the age of the permit compared to the average processing cycle time.

In our opinion, in order to evaluate if the Building Program is cost-recovery there needs to be a stronger nexus between the revenue in the Building Reserve Fund and the inspection services that need to be performed in subsequent fiscal years. The Administration needs to estimate the year-end backlog of works-in-progress and set aside sufficient revenue to cover the cost of services to be provided. According to the Portland, Oregon consultant, a benefit of estimating works-in-progress is that the "estimated dollar value can be used to help validate the adequacy of the 'general reserve' and also the possible effect" on cost recovery of the Building Program.

We recommend that the Building Division:

Recommendation #3

Develop a process for accounting for works-in-progress to ensure a proper matching of Building Program revenues and costs.

The Administration's Method For Paying For Long-Term Assets Skews The Division's Cost Recovery Picture

In evaluating if the Building Program is cost-recovery, we found that the Administration's method for paying for long-term assets skews the Division's cost-recovery picture. For example, the Administration essentially used surplus revenue to pay for the Integrated Development Tracking System (IDTS). The IDTS is expected to integrate various land-use tracking systems into one comprehensive system that will contain all permit, land use, and geographic data pertaining to a specific parcel. This "integrated" system will provide the means of tracking development projects from start to finish. According to the IDTS project manager, the IDTS is expected to cost $7.5 million, of which the building permit fees paid for about 75 percent, or about $5.6 million. This $5.6 million was derived from permit fees paid between 1995-96 and 1997-98. As a result, Building Division customers during those years essentially paid for a computer system that will benefit future Building Division customers.

In our opinion, the Division needs to improve how it plans and pays for long-term assets, such as computer systems. The ICMA's Management Information Service (MIS) reported that costs such as capital replacement (such as computer systems) are frequently unrecognized in cost of service calculations. The MIS also noted that "local governments have unwittingly allowed capital facilities to deteriorate because they have not fully accounted for the costs that can appropriately be recovered from beneficiaries of the services provided by those facilities." Specifically, MIS also reported that any revenues for capital replacement should be "set aside in appropriate reserve funds. . . for that purpose and not spent for operational expenses or for capital additions."

We recommend that the Building Division:

Recommendation #4

Establish a policy and process to pay for long-term capital or asset acquisitions.

CONCLUSION

The Building Division cannot demonstrate that its building fees are cost-recovery and that it has properly accounted for all building fee revenues. By conducting a comprehensive cost of service study that identifies the cost of providing service based on project type and adopting a process to account for works-in-progress and plan for long-term capital needs and asset acquisitions the Division, 1) will be able to determine the total cost of providing services and accurately and fairly price services, 2) have added assurance that its Building Program is in compliance with State law and the Attorney General and Legislative Counsel's opinions on permit fees, and 3) will have building fees that will be better able to withstand political and public scrutiny.

RECOMMENDATIONS

We recommend that the Building Division:

Recommendation #1 **Regularly conduct or cause to be conducted a comprehensive cost of service study that**

- **Calculates the full cost (both direct and indirect) of providing building-related services by project type;**
- **Compares the identified program costs with building fee revenues currently received for those services; and**
- **Identifies achievable building fee recovery levels based on the cost of those services. (Priority 3)**

Recommendation #2 **Implement a fee schedule that results in the assessment of fees that are commensurate with the cost of providing service. (Priority 3)**

Recommendation #3 **Develop a process for accounting for works-in-progress to ensure a proper matching of Building Program revenues and costs. (Priority 3)**

Recommendation #4 **Establish a policy and process to pay for long-term capital or asset acquisitions. (Priority 3)**